Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matters of	)	
	)	
Section 272(b)(1)'s "Operate Independently" Requirement for Section 272 Affiliates	)	WC Docket No. 03-228
	)	
Petition of SBC for Forbearance from the Prohibition of Sharing Operating, Installation, and Maintenance Functions under Sections 53 203(a)(2) and 53 203(a)(3) of the Commission's Rules and Modification of Operating, Installation, and Maintenance Conditions Contained in the SBC/Ameritech Merger Order	)	CC Docket Nos. 96-149, 98-141
	)	
Petition of BellSouth Corporation for Forbearance from the Prohibition of Sharing Operating, Installation, and Maintenance Functions Under Section 53.203(a)(2)-(3) of the Commission's Rules	)	CC Docket No. 96-149
	)	
Review of Regulatory Requirements for Incumbent LEC Broadband Telecommunications Services	)	CC Docket No. 01-337

REPORT AND ORDER IN WC DOCKET NO. 03-228
MEMORANDUM OPINION AND ORDER IN CC DOCKET NOS. 96-149, 98-141, 01-337

Adopted: March 11, 2004 **Released: March 17, 2004**

By the Commission: Chairman Powell, and Commissioner Abernathy issuing separate statements, Commissioners Copps and Adelstein concurring and issuing separate statements.

I. INTRODUCTION

1. On November 4, 2003, we released a Notice of Proposed Rulemaking[1] to re-examine our rules implementing the "operate independently" requirement of section 272(b)(1) of

[1] *See Section 272(b)(1)'s "Operate Independently" Requirement for Section 272 Affiliates*, WC Docket No 03-228, Notice of Proposed Rulemaking, 18 FCC Rcd 23538 (2003) (*Notice*) Comments were filed on December 10, 2003 by Americatel Corporation (Americatel), AT&T Corp. (AT&T), BellSouth Corporation (BellSouth), Qwest Services Corp (Qwest), SBC Communications Inc (SBC), Sprint Corporation (Sprint), United States Telecom

the Communications Act of 1934, as amended (the Act).[2] In this Order, we conclude, based on the reexamination of our rules, that the prohibition against sharing by BOCs and their section 272 affiliates of operating, installation, and maintenance (OI&M) functions is not a necessary component of the statutory requirement to "operate independently" and is an overbroad means of preventing cost misallocation or discrimination by Bell operating companies (BOCs) against unaffiliated rivals.[3] We further conclude that we should retain the prohibition against joint ownership by BOCs and their section 272 affiliates of switching and transmission facilities, or the land and buildings on which such facilities are located.[4] In addition, because of our actions in this Order, we dismiss as moot petitions filed by SBC and BellSouth, pursuant to section 10 of the Act, seeking forbearance from the OI&M sharing prohibition. Finally, we grant SBC's request for modification of the *SBC/Ameritech Merger Order*[5] conditions related to OI&M services to the extent that these merger conditions are incorporated into the conditions of the *SBC Advanced Services Forbearance Order*.[6]

II. BACKGROUND

A. Sections 271 and 272

2 Sections 271 and 272 of the Act, which were added by the Telecommunications Act of 1996 (1996 Act), establish a comprehensive framework governing BOC provision of "interLATA service."[7] Pursuant to section 271, neither a BOC nor a BOC affiliate may provide in-region, interLATA service prior to receiving section 271(d) authorization from the

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Association (USTA), Verizon Telephone and Long Distance Companies (Verizon), and WorldCom, Inc. d/b/a MCI (MCI). Reply comments were filed on December 22, 2003 by AT&T, BellSouth, MCI, Qwest, SBC, Sprint, and Verizon. *See Pleading Cycle Established for Comments on Section 272(b)(1)'s "Operate Independently" Requirement for Section 272 Affiliates*, WC Docket No. 03-228, Public Notice, 18 FCC Rcd 24373 (2003).

[2] 47 U.S.C. § 272(b)(1).

[3] Sections 53.203(a)(2)-(3) of the Commission's rules prohibit a BOC's section 272 affiliate from sharing OI&M functions with the BOC or another BOC affiliate. 47 C.F.R. § 53.203(a)(2)-(3).

[4] 47 C.F.R. § 53.203(a)(1).

[5] *Applications of Ameritech Corp., Transferor, and SBC Communications Inc., Transferee, For Consent to Transfer Control of Corporations Holding Commission Licenses and Lines Pursuant to Sections 214 and 310(d) of the Communications Act and Parts 5, 22, 24, 25, 63, 90, 95 and 101 of the Commission's Rules*, CC Docket No. 98-141, Memorandum Opinion and Order, 14 FCC Rcd 14712 (1999) (*SBC/Ameritech Merger Order*), *vacated in part sub nom., Ass'n of Communications Enters. v. FCC*, 235 F.3d 662 (D.C. Cir. 2001) (*ASCENT v. FCC*).

[6] *Review of Regulatory Requirements for Incumbent LEC Broadband Telecommunications Services*, CC Docket No. 01-337, Memorandum Opinion and Order, 17 FCC Rcd 27000 (2002) (*SBC Advanced Services Forbearance Order*).

[7] The term "interLATA service" is defined in the Act as "telecommunications between a point located in a local access and transport area and a point located outside such area." 47 U.S.C. § 153(21). "Telecommunications" is defined as "the transmission, between or among points specified by the user, of information of the user's choosing, without change in the form or content of the information as sent and received." 47 U.S.C. § 153(43).

Commission [8] Section 272 requires BOCs, once authorized to provide in-region, interLATA services in a state under section 271, to provide those services through a separate affiliate until the section 272 separate affiliate requirement sunsets for that particular state.[9] In addition, section 272 imposes structural and transactional requirements on section 272 separate affiliates, including the requirement to "operate independently" from the BOC.[10]

B. The Non-Accounting Safeguards Orders

3 Section 272(b)(1) directs that the separate affiliate required pursuant to section 272(a) "shall operate independently from the [BOC] "[11] The Commission adopted rules to implement the "operate independently" requirement that prohibit a BOC and its section 272 affiliate from (1) jointly owning switching and transmission facilities or the land and buildings on which such facilities are located;[12] and (2) providing OI&M services associated with each other's facilities.[13] OI&M functions generally include all activity related to installing, operating,

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[8] 47 U S C § 271(b)(1) BOCs have now been granted section 271 authority to provide interLATA services in all of their in-region states *See* FCC, *Federal Communications Commission Authorizes Qwest to Provide Long Distance Service in Arizona, Bell Operating Companies Long Distance Application Process Concludes, Entire Country Authorized for "All Distance" Service*, News Release (Dec 3, 2003).

[9] *See* 47 U S C. § 272(a)(2)(B), (f)(1) (requiring separate affiliate for three years "unless the Commission extends such 3-year period by rule or order"), *see also Section 272(f)(1) Sunset of the BOC Separate Affiliate and Related Requirements*, WC Docket No 02-112, Memorandum Opinion and Order, 17 FCC Rcd 26869, 26876, para 13 (2002) ("We find that section 272(f)(1) should be interpreted as providing for a state-by-state sunset of the section 272 separate affiliate and related requirements ") Even when the separate affiliate obligation sunsets, BOCs may elect, and have elected, to continue the affiliate structure due to the dominant carrier regulations to which they would be subject if they integrated. Therefore, this rule change may have relevance beyond the formal sunset period *See generally Section 272(f)(1) Sunset of the BOC Separate Affiliate and Related Requirements, 2000 Biennial Regulatory Review Separate Affiliate Requirements of Section 64 1903 of the Commission's Rules*, WC Docket No 02-112, CC Docket No 00-175, Further Notice of Proposed Rulemaking, 18 FCC Rcd 10914 (2003) The section 272 provisions (other than section 272(e)) have sunset in New York, Texas, Kansas, and Oklahoma *See Section 272 Sunsets for Verizon in New York State by Operation of Law on December 23, 2002 Pursuant to Section 272(f)(1)*, WC Docket No. 02-112, Public Notice, 17 FCC Rcd 26864 (2002), *Section 272 Sunsets for SBC in the State of Texas by Operation of Law on June 30, 2003 Pursuant to Section 272(f)(1)*, WC Docket No 02-112, Public Notice, 18 FCC Rcd 13566 (2003), *Section 272 Sunsets for SBC in Kansas and Oklahoma by Operation of Law on January 22, 2004 Pursuant to Section 272(f)(1)*, WC Docket No 02-112, Public Notice, FCC 04-14 (rel. Jan 22, 2004)

[10] 47 U S C § 272(b)(1)

[11] *Id.*

[12] *See Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended*, CC Docket No 96-149, First Report and Order and Further Notice of Proposed Rulemaking, 11 FCC Rcd 21905, 21981-84, paras 158-62 (1996) (*Non-Accounting Safeguards Order*), Order on Reconsideration, 12 FCC Rcd 2297 (1997), Second Order on Reconsideration, 12 FCC Rcd 8653 (1997) (*Non-Accounting Safeguards Second Order on Recon.*), *aff'd sub nom Bell Atlantic Tel Cos v FCC*, 131 F 3d 1044 (D C Cir 1997), Third Order on Reconsideration, 14 FCC Rcd 16299 (1999) (*Non-Accounting Safeguards Third Order on Recon.*), 47 C F.R. § 53 203(a)(1)

[13] *See Non-Accounting Safeguards Order*, 11 FCC Rcd at 21981-82, 21984-86, paras. 158, 163-66; 47 C.F.R § 53 203(a)(2)-(3). The Commission reasoned that allowing joint ownership of facilities and sharing of OI&M functions between BOCs and their section 272 affiliates could create opportunities for improper cost allocation and

and maintaining (*e g* , making repairs to) switching and transmission facilities.[14] Specifically with regard to these functions, the Commission's rules prohibit a section 272 affiliate from performing OI&M functions associated with the BOC's facilities. Likewise, they bar a BOC or any BOC affiliate, other than the section 272 affiliate itself, from performing OI&M functions associated with the facilities that its section 272 affiliate owns or leases from a provider other than the BOC with which it is affiliated [15]

4. On reconsideration, the Commission affirmed its interpretation of section 272(b)(1)'s "operate independently" requirement but also confirmed that it viewed adoption of the particular rules as a permissible interpretation of section 272 rather than a mandate of the provision itself [16] Specifically, rejecting "plain language" statutory construction arguments, the Commission affirmed that "there is no plain or ordinary meaning of ["operate independently"], as used in section 272(b)(1), that compels us to adopt a particular set of restrictions "[17] Because the term is ambiguous, the Commission concluded that it had discretion to interpret the term in a manner consistent with Congressional intent [18] Finally, the Commission reiterated that, in adopting rules to implement section 272(b)(1)'s "operate independently" requirement, it was choosing, as Congress intended, a balance between efficiencies in BOC operations and protections against anticompetitive behavior.[19]

C. The OI&M Forbearance Petitions

5. Verizon, SBC, and BellSouth each filed petitions for forbearance seeking relief from the OI&M sharing prohibition.[20] On November 3, 2003, we denied the Verizon Petition,

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discrimination that the separate affiliate requirement was intended to prevent. *See id.* at 21981-82, para. 158 At the same time, the Commission recognized that these restrictions on sharing of facilities and OI&M services impose costs, including inefficiencies within the BOCs' corporate structures, and that the economies of scale and scope inherent to integration produce economic benefits to consumers *See id.* at 21983-84, 21986, 21991, paras. 162, 167-68, 179, *see also Non-Accounting Safeguards Second Order on Recon.*, 12 FCC Rcd at 8683, para. 55

[14] The Commission clarified that "'sharing of services' means the provision of services by the BOC to its section 272 affiliate, or vice versa " *Non-Accounting Safeguards Order*, 11 FCC Rcd at 21990-91, para 178.

[15] *See Non-Accounting Safeguards Order*, 11 FCC Rcd at 21981-82, 21984-86, paras 158, 163-66; 47 C.F.R. § 53.203(a)(2)-(3)

[16] *See Non-Accounting Safeguards Third Order on Recon* , 14 FCC Rcd at 16309-11, paras. 13-15, *see also id* at 16314-15, para 20 (affirming the OI&M sharing prohibition)

[17] *Id* at 16310, para 14

[18] *Id.* at 16310-11, paras 14-15 (citing *Pauley v Bethenergy Mines, Inc* , 501 U.S 680, 696 (1991) ("Judicial deference to an agency's interpretation of ambiguous provisions of the statutes it is authorized to implement reflects a sensitivity to the proper roles of the political and judicial branches. .. [T]he resolution of ambiguity in a statutory text is often more a question of policy than of law "))

[19] *See Non-Accounting Safeguards Third Order on Recon* , 14 FCC Rcd at 16310, para. 14.

[20] Petition of Verizon for Forbearance from the Prohibition of Sharing Operating, Installation, and Maintenance Functions under Section 53.203(a)(2) of the Commission's Rules, CC Docket No 96-149 (filed Aug 5, 2002) (Verizon Petition), Petition of SBC for Forbearance from the Prohibition of Sharing Operating, Installation, and Maintenance Functions under Sections 53 203(a)(2) and 53.203(a)(3) of the Commission's Rules and

concluding that we may not forbear from applying requirements of section 272 that are incorporated by reference into section 271 until section 272 is "fully implemented."[21] At the same time, the Commission adopted the *Notice* in this proceeding to seek comment on whether it should, through a rulemaking, modify or eliminate the rules adopted to implement section 272(b)(1)'s "operate independently" requirement, including the OI&M sharing prohibition.

6 Along with its forbearance petition, SBC requested a modification of the *SBC/Ameritech Merger Order* condition that limited OI&M sharing between the advanced services affiliate and the BOC or other affiliates.[22] As part of that request, SBC also asked that the Commission clarify that "elimination of the OI&M restrictions would not affect the relief from tariffing" granted in the *SBC Advanced Services Forbearance Order*.[23] Although the advanced services separate affiliate condition of the merger order itself has technically sunset,[24] SBC continues to comply, through its affiliate Advanced Solutions, Inc. (ASI), with the merger condition as a condition of the forbearance order.[25] In support of its requests, SBC generally

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Modification of Operating, Installation, and Maintenance Conditions Contained in the SBC/Ameritech Merger Order, CC Docket Nos 96-149, 98-141 (filed June 5, 2003) (SBC Petition); Petition of BellSouth Corporation for Forbearance from the Prohibition of Sharing Operating, Installation, and Maintenance Functions Under Section 53 203(a)(2)-(3) of the Commission's Rules, CC Docket No 96-149 (filed July 14, 2003) (BellSouth Petition).

[21] *See Petition of Verizon for Forbearance from the Prohibition of Sharing Operating, Installation, and Maintenance Functions Under Section 53 203(a)(2) of the Commission's Rules*, CC Docket No 96-149, Memorandum Opinion and Order, 18 FCC Rcd 23525 (2003) (*Verizon OI&M Forbearance Order*), *appeal pending, Verizon Tel Cos v FCC*, D C Cir No 03-1404. Although we denied the Verizon Petition, we did not reach the merits of the three-prong analysis under section 10(a) In this Order, we dismiss SBC's and BellSouth's forbearance petitions as moot

Qwest also filed a petition for forbearance On November 14, 2003, the Wireline Competition Bureau (Bureau) granted Qwest's request to withdraw and dismissed Qwest's forbearance petition *See Petition of Qwest Services Corporation for Forbearance from the Prohibition of Performing Operating, Installation, and Maintenance Functions under Section 53 203(a)(2)-(3) of the Commission's Rules*, CC Docket No 96-149, Order, 18 FCC Rcd 24016 (WCB 2003), Petition of Qwest Services Corporation for Forbearance from the Prohibition of Performing Operating, Installation, and Maintenance Functions under Section 53.203(a)(2)-(3) of the Commission's Rules, CC Docket No 96-149 (filed Oct 3, 2003)

[22] *See* SBC Petition at 25-27 Comments on the SBC Petition were filed on July 1, 2003 by AT&T, Sprint, Verizon, and MCI Reply comments were filed on July 15, 2003 by SBC *See Comment Dates Set for Petition for Forbearance and Modification Filed by SBC Communications Inc* , CC Docket Nos 96-149, 98-141, Public Notice, 18 FCC Rcd 11504 (2003)

[23] SBC Petition at 26 In its petition, SBC refers to the *SBC Advanced Services Forbearance Order* as the "ASI Tariffing Forbearance Order " *See, e g* , SBC Petition at 2 n 4

[24] *See SBC Advanced Services Forbearance Order*, 17 FCC Rcd at 27002-03, paras. 3-5, *SBC/Ameritech Merger Order*, 14 FCC Rcd at 14988-89, Condition I 12, *cf Application of GTE Corporation, Transferor, and Bell Atlantic Corporation, Transferee for Consent to Transfer Control of Domestic and International Section 214 and 310 Authorizations and Applications to Transfer Control of a Submarine Cable Landing License*, CC Docket No 98-184, Order, 16 FCC Rcd 16915, 16916, para 2 n 5 (Com Car Bur 2001) (concluding that, as a result of the holding in *ASCENT v FCC*, a similar condition for Verizon's advanced services operations sunset on January 9, 2002)

[25] *See SBC Advanced Services Forbearance Order*, 17 FCC Rcd at 27003, 27008, para 5, 13

argued that eliminating these OI&M conditions would be in the public interest for the same reasons that eliminating the OI&M sharing prohibition under section 272(b)(1) would be.[26]

III. DISCUSSION

A. "Operate Independently"

1. Overview

7. In this Order, we evaluate whether to modify or eliminate the current requirements under section 272(b)(1) that prohibit OI&M sharing and bar the joint ownership of certain facilities.[27] As an initial matter, we must evaluate whether we have the discretion to modify the requirements we have promulgated to give meaning to the term "operate independently" under subsection (b)(1). We determine at the outset that we have such discretion. In reaching this conclusion, we reject commenters' arguments that we *must* retain both requirements in order to give meaning to section 272(b)(1)'s "operate independently" language.[28] We also reject AT&T's suggestion that "operate independently" has a plain meaning, or at least that it must mean that the section 272 affiliate and the BOC must operate as fully independent interests.[29] We reaffirm instead the conclusion of the previous Commission that section 272(b)(1) is ambiguous.[30]

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[26] *See* SBC Petition at 26-27

[27] 47 C.F.R § 53.203(a)

[28] *See* AT&T Comments at 29, 31, MCI Comments at 1-4, Sprint Comments at 4, AT&T Reply at 8-10, 14, MCI Reply at 1-2, Sprint Reply, Attach 1 at 3-4, Attach. 2 at 4, 10 *But see* Qwest Reply at 8-9, Verizon Reply at 2-4 In the *Non-Accounting Safeguards Order*, the Commission concluded that, based on the principle that a statute should be construed so as to give effect to each of its provisions, the "operate independently" language of section 272(b)(1) imposes requirements on section 272 separate affiliates beyond those detailed in section 272(b)(2)-(5) To give independent meaning to the "operate independently" language, the Commission adopted the OI&M sharing prohibition and the joint facilities ownership restriction *See Non-Accounting Safeguards Order*, 11 FCC Rcd at 21981, para 156 Section 272(b)(2)-(5) provides that the section 272 separate affiliate "(2) shall maintain books, records, and accounts in the manner prescribed by the Commission which shall be separate from the books, records, and accounts maintained by the [BOC] of which it is an affiliate; (3) shall have separate officers, directors, and employees from the [BOC] of which it is an affiliate, (4) may not obtain credit under any arrangement that would permit a creditor, upon default, to have recourse to the assets of the [BOC], and (5) shall conduct all transactions with the [BOC] of which it is an affiliate on an arm's length basis with any such transactions reduced to writing and available for public inspection " 47 U S C § 272(b)(2)-(5)

[29] *See, e g*, AT&T Reply at 8-10, Letter from Frank S Simone, Government Affairs Director, AT&T, to Marlene H Dortch, Secretary, Federal Communications Commission, WC Docket No 03-228, Attach at 1-6 (filed Feb 20, 2004) *But see* Letter from Colin S Stretch, Counsel for SBC, to Marlene H Dortch, Secretary, Federal Communications Commission, WC Docket No 03-228, Attach at 1-4 (filed Feb 26, 2004) (SBC Feb. 26, 2004 *Ex Parte* Letter), Letter from Dee May, Vice President – Federal Regulatory Affairs, Verizon, to Marlene H Dortch, Secretary, Federal Communications Commission, WC Docket No 03-228, Attach at 1-4 (filed Mar 4, 2004), Letter from Melissa E Newman, Vice President – Federal Regulatory, Qwest, to Marlene H Dortch, Secretary, Federal Communications Commission, WC Docket No. 03-228 at 2-3 (filed Feb 4, 2004) (Qwest Feb 4, 2004 *Ex Parte* Letter)

[30] *See Non-Accounting Safeguards Order*, 11 FCC Rcd at 21917-18, para 23, *id.* at 21976, para 147 ("The Act does not elaborate on the meaning of the phrase 'operate independently '"), *id.* at 21998-87, paras 156-70

Significantly, while the Commission concluded in the *Non-Accounting Safeguards Order* that specific structural safeguards merited adoption because their benefits appeared to outweigh their anticipated costs,[31] this result was not compelled by the statutory language itself.[32] In fact, to the extent that AT&T argues that the section 272 affiliate and the BOC must operate as fully independent interests, its position is undermined by the section 272 statutory scheme, which expressly envisions the sharing of some functions.[33] This contemplated sharing strongly suggests that Congress never envisioned that the section 272 affiliate would operate as an entity that was entirely walled off from the BOC. In sum, we reject AT&T's analysis as being too rigid, failing to recognize that the ambiguous phrase "operate independently" is subject to a range of possible meanings, and that the Commission's application of this term may change over time as circumstances evolve.

8. We conclude below that we should eliminate the OI&M sharing prohibition but retain the joint facilities ownership restriction under section 272(b)(1), consistent with our obligation to implement the statutory directive that the section 272 affiliate and the BOC "operate independently." An agency is free to modify its interpretation of an ambiguous statutory provision when other reasonable interpretations may exist, provided that it acknowledges its change of course and provides a rational basis for its shift in policy.[34] In fact, a reexamination of rules is particularly appropriate where, as here, we have gained more experience over time and new ways of achieving regulatory goals have developed In the instant situation, we have chosen to reexamine the rules adopted to implement section 272(b)(1) in light of our eight years of experience in implementing the 1996 Act (including applicable cost allocation and nondiscrimination rules), our additional experience with monitoring section 272 affiliates, and, more generally, the growth of competition in all telecommunications markets.[35]

9. The evaluation we undertake in this Order employs the methodology used by the previous Commission in implementing section 272(b)(1), where we balance the costs of a given restriction against its benefits. Like the previous Commission, we weigh the costs of structural

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(interpreting "operate independently"); *Non-Accounting Safeguards Third Order on Recon.*, 14 FCC Rcd at 16309-11, paras 13-15

[31] *See, e.g., Non-Accounting Safeguards Order*, 11 FCC Rcd at 21982, 21984, paras. 159, 163

[32] As discussed above, the rules adopted to implement the "operate independently" requirement were policy choices within a range of reasonable options for interpreting the statutory provision, not mandates of section 272(b)(1) itself Section 272(b)(1) directs BOCs and their section 272 affiliates to "operate independently" but does not otherwise specify requirements As a result, the Commission concluded that the term "operate independently" was ambiguous

[33] *See* 47 U S C § 272(c)(1) (imposing a nondiscrimination requirement on a BOC's dealings with its section 272 affiliate)

[34] *See* 5 U S C § 553, 47 U S C § 201(b), *AT&T Corp v Iowa Utils Bd.*, 525 U S 366, 377-78 (1999), *Greater Boston Television Corp v FCC*, 444 F 2d 841, 852 (D.C Cir. 1972) (explaining that an agency may change its rules so long as it supplies a reasoned analysis that prior policies and standards are being deliberately changed); *see also* Americatel Comments at 10, BellSouth Comments at 7 n 13, Verizon Comments at 6; Verizon Reply at 2, 7.

[35] *See Notice*, 18 FCC Rcd at 23541, para 6

separation, including inefficiencies within BOC operations, against the benefits of protecting consumers from the risks of cost misallocation and discrimination. However, on the record before us in this proceeding, we conclude that the benefits of the OI&M sharing prohibition no longer outweigh the costs In contrast, we find that the joint facilities ownership restriction continues to have benefits that exceed its costs. We also conclude that retaining only one of the two existing restrictions initially promulgated under section 272(b)(1) continues to give reasonable meaning to the requirement that the section 272 affiliate "operate independently" from the BOC.

10 In that regard, we expressly reject AT&T's contention that without the OI&M sharing prohibition, the services of the affiliate and BOC would be so integrated as to preclude independent operation within the meaning of subsection (b)(1). In the *Non-Accounting Safeguards Order*, the Commission "recognize[d] the inherent tension between the 'operate independently' requirement and allowing the integration of services."[36] In large measure on the basis of our cost-benefit analysis, we modify the restrictions implementing subsection (b)(1), making them somewhat different from those of seven years ago But that does not mean that the section 272 affiliate and the BOC are now allowed to become one and the same entities. To the contrary, we continue to give vitality to the phrase "operate independently" by ensuring that the entities retain separate ownership of facilities and fully comply with the other requirements of section 272(b), including separate governance and arm's length dealings.

11 In reaching this conclusion, we reject AT&T's argument that a section 272 affiliate whose OI&M is obtained under an arm's length contract with the BOC is so "dependent" on the BOC as to violate the "operate independently" requirement that Congress has required.[37] That argument fails to recognize the inherent ambiguity of the phrase we must construe We note that the dictionary offers a range of definitions of "independent," some implying a narrower scope, such as "self-governing,"[38] whereas others suggest a broader meaning, such as "not affiliated with a larger controlling unit "[39] Importantly, however, the dictionary offers no precise meaning of the term as AT&T suggests Rather, we believe that the Commission's interpretation of the term "operate independently" should fit within the plausible meanings suggested by these multiple definitions At a minimum, then, we must ensure that the section 272 affiliate will remain self-governing (as required by section 272(b)(3)) [40] The approach we adopt here satisfies that threshold. Indeed, other provisions of the Act strongly suggest that an OI&M sharing prohibition is not inherent in the term "operate independently." Section 274(b) requires the BOC and its electronic publishing affiliate to be "operated independently," and goes on to specifically prohibit the BOC from "perform[ing] . . . installation, or maintenance of equipment on behalf of

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36 *Non-Accounting Safeguards Order*, 11 FCC Rcd at 21986, para 168

37 AT&T Reply at 8

38 *Merriam Webster's Collegiate Dictionary* 591(10th ed 1996) (*Webster's Dictionary*), *see* SBC Feb 26, 2004 *Ex Parte* Letter, Attach at 1 (citing *American Heritage Dictionary* 654 (2d Ed 1991))

39 *Webster's Dictionary* at 591

40 47 U S C § 272(b)(3)

[the affiliate]"[41] That additional language would be unnecessary if the term "operate independently" necessarily foreclosed OI&M sharing, as AT&T urges.

12. For these reasons, we conclude that the separate facilities ownership requirement under section 272(b)(1), in combination with the remaining requirements of section 272(b), reasonably ensures that the section 272 affiliate will continue to "operate independently" from the BOC. Although we retain the discretion to impose additional requirements under subsection (b)(1) should we find they are needed, we do not believe that this provision *compels* us to prohibit OI&M sharing on the record now before us. We reiterate, as did the prior Commission, that there is a range of options available to the Commission in implementing this ambiguous provision, and here we have chosen an interpretation that fulfills the statutory directive Consistent with our previous methodology, we have reasonably chosen to eliminate restrictions (on OI&M sharing) after finding that their anticipated costs exceed their benefits.

2. *ASCENT v. FCC*

13. Further, we reject AT&T's argument that our action to eliminate the OI&M sharing prohibition is foreclosed by the D.C. Circuit's decision in *ASCENT v FCC*.[42] As AT&T states, we recently held that section 10(d) prohibits us from forbearing from the requirements of section 272 until they are fully implemented.[43] According to AT&T, the D.C. Circuit held in *ASCENT v FCC* that "even if the Commission does 'not explicitly invoke[] forbearance authority,' the Commission acts unlawfully where it unreasonably interprets the Act's provisions in order to reach 'the very result it had previously rejected.'"[44] AT&T appears to contend that, once the Commission determines that the requirements of a statutory provision fall within the section 10(d) limitation on forbearance, the Commission's rulemaking authority to interpret ambiguous terms within that provision also is restricted.

14 The *ASCENT v. FCC* decision does not support AT&T's proposition. In *ASCENT v FCC*, the appellant argued that the separate affiliate condition of the *SBC/Ameritech Merger Order* was "simply a device to accomplish indirectly what the statute clearly forbids," specifically, the exercise of forbearance that was prohibited by section 10(d).[45] In the *SBC/Ameritech Merger Order*, the Commission did not expressly exercise forbearance under section 10 but instead reinterpreted the meaning of the term "successor or assign" in such a way

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41 47 U S C § 274(b)(7)(B) We found that these differences strongly suggest that the term "operate independently" must be read in the context of the specific statutory section *See Non-Accounting Safeguards Order*, 11 FCC Rcd at 21981, para 157 Moreover, the fact that Congress found it necessary to outline in detail the "operate independently" requirements for section 274 affirm our finding that the term is ambiguous

42 *See* AT&T Comments at 29-30 (citing *ASCENT v FCC*, 235 F 3d at 666); *see also* Sprint Reply at 2-3 *But see* Letter from David L Lawson, Counsel for AT&T, to Marlene Dortch, Secretary, Federal Communications Commission, CC Docket No 96-149 at 8 (filed July 9, 2003).

43 *See* AT&T Comments at 29 (citing *Verizon OI&M Forbearance Order*, 18 FCC Rcd 23525)

44 *See* AT&T Comments at 30 (citing *ASCENT v FCC*, 235 F 3d at 666)

45 *ASCENT v FCC*, 235 F.3d at 665

to relieve the advanced services separate affiliate created under the merger order from obligations under section 251(c).[46] The D.C. Circuit expressly held that "[t]he Commission's interpretation of the Act's structure is unreasonable."[47] Thus, the court did not dispute the Commission's authority to interpret ambiguous statutory provisions.[48] Instead, it ruled on the merits of the Commission's interpretation, relying on the well-established principle that agency interpretations must be reasonable.[49] Indeed, AT&T's characterization of the holding concedes that this course of action would be unlawful only if the Commission "*unreasonably* interprets the Act's provisions."[50]

15. In this Order, we do not exercise forbearance under section 10.[51] Instead, we exercise our rulemaking authority to adopt, modify, or eliminate rules of general applicability. In this instance, we are reexamining our interpretation of section 272(b)(1). Our elimination here of the OI&M sharing prohibition is a reasonable interpretation of section 272(b)(1) under our rulemaking authority, and thus section 10(d) of the Act is not implicated, and the *ASCENT v FCC* decision is distinguished from our actions today.

B. Operating, Installation, and Maintenance Services

16. As discussed below, on the record now before us, we find that the OI&M sharing prohibition is an overbroad means of preventing anti-competitive conduct and poses significant costs that outweigh potential benefits, especially given that our non-structural safeguards should effectively prevent cost misallocation and discrimination. Because this prohibition on OI&M sharing is not directly compelled by section 272(b)(1), we eliminate sections 53.203(a)(2)-(3) of the Commission's rules.[52]

17. ***Benefits of Non-structural Safeguards.*** The OI&M sharing prohibition requires the BOCs' provision of OI&M functions associated with exchange access services, such as switched access and special access, to be structurally separate from the section 272 affiliates'

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46 *See id.*

47 *Id.* at 668

48 *See, e.g., id.* at 665, 668, *see also* Qwest Reply at 6-7, SBC Reply at 2-3, Verizon Reply at 2 n.3

49 *See, e.g., Bell Atl. Tel. Cos. v. FCC*, 131 F.3d 1044, 1048-49 (D.C. Cir. 1997) (citing *Troy Corp. v. Browner*, 120 F.3d 277, 285 (D.C. Cir. 1997) (agency interpretation must be "reasonable and consistent with the statutory purpose"), *Cleveland, Ohio v. U.S. Nuclear Regulatory Comm'n*, 68 F.3d 1361, 1367 (D.C. Cir. 1995) (agency interpretation must be "reasonable and consistent with the statutory scheme and legislative history")), *see also* Qwest Reply at 7 nn.23-24

50 *See* AT&T Comments at 30 (emphasis added).

51 As noted above, we have expressly held that we may not forbear from the OI&M sharing prohibition until section 272 is "fully implemented," as required by section 10(d). *See Verizon OI&M Forbearance Order*, 18 FCC Rcd 23525

52 We do not disturb the requirements of section 53.203(a)(1). This provision is unrelated to the OI&M sharing prohibition and implements section 272(b)(1)'s "operate independently" requirement

provision of OI&M functions associated with interLATA services.[53] This separation was intended to provide the Commission with the ability to better monitor the performance of OI&M functions associated with exchange access services and enforce the BOCs' obligations under the Act not to cost misallocate or discriminate against unaffiliated rivals in the provision of interLATA services.[54] Those opposed to eliminating the OI&M sharing prohibition – Americatel, AT&T, MCI, and Sprint – generally assert that structural regulation, such as the current OI&M restriction, is more effective than a non-structural approach and that allowing for shared provision of OI&M functions will provide more opportunity for BOCs to engage undetected in cost misallocation, price discrimination (*e g* , price squeeze), and performance discrimination.[55]

18. While structural safeguards may be helpful in monitoring such behavior, they can be a costly and burdensome way to do so, particularly if non-structural safeguards can afford a similar level of transparency and protect against discrimination.[56] In the context of OI&M functions, we conclude that the existing non-structural safeguards are well-tailored and sufficient to provide effective and efficient protections against cost misallocation and discrimination by BOCs.[57] Based on the record in this proceeding, we do not expect that eliminating the OI&M

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[53] The OI&M sharing prohibition also prohibits a BOC affiliate, other than the section 272 affiliate itself, from performing OI&M functions for the section 272 affiliate *See* 47 C.F R. § 53.203(a)(3) In adopting this provision, the Commission reasoned that allowing a third affiliate to provide OI&M services to the section 272 affiliate would create a loophole around the OI&M sharing prohibition of the separate affiliate requirement *See Non-Accounting Safeguards Order*, 11 FCC Rcd at 21984, para 163, *Non-Accounting Safeguards Third Order on Recon* , 14 FCC Rcd at 16314-15, para 20 Our elimination of the OI&M sharing prohibition includes the prohibition against a non-section 272 affiliate providing OI&M services to a section 272 affiliate Because the primary purpose of the rule was to ensure that the prohibition was not easily avoided and we now have lifted that prohibition in this Order, there is also no need to prohibit sharing of OI&M services between affiliates

[54] *See Non-Accounting Safeguards Order*, 11 FCC Rcd at 21984, para 163

[55] *See* Americatel at 4, AT&T Comments at 3, 23, Sprint Comments at 2-4, Attach 3 at 12, Attach 4 at 4, AT&T Reply at 17-18, MCI Reply at 2-5, Sprint Reply, Attach. 2 at 11, 15

[56] *See, e g* , Qwest Comments at 5, Verizon Comments at 10-11, Qwest Reply at 9-12 Recognizing the effectiveness of non-structural safeguards, the Commission declined, in the *Non-Accounting Safeguards Order*, to impose additional structural restrictions on the joint ownership of other property between the BOC and its section 272 affiliate or on the sharing of services The Commission concluded that additional structural separation requirements were unnecessary given non-structural safeguards, including the nondiscrimination provisions, the biennial audit requirement, and other requirements imposed by section 272 *See Non-Accounting Safeguards Order*, 11 FCC Rcd at 21986, para 167 ("We decline to impose additional structural separation requirements given the nondiscrimination safeguards, the biennial audit requirement, and other public disclosure requirements imposed by section 272 In combination with the accounting protections established in the *Accounting Safeguards Order*, we believe the requirements set forth herein will protect against potential anticompetitive behavior."), *see also id* at 21983-84, para 162 ("We find that joint ownership of other property, such as office space and equipment used for marketing or the provision of administrative services, may provide economies of scale and scope without creating the same potential for discrimination by the BOCs Moreover, we believe that the Commission's accounting rules, the separate books, records, and accounts requirement of section 272(b); and the audit requirement of section 272(d) provide adequate protection against the potential for improper cost allocation.") (citations omitted)

[57] Because we conclude that the existing safeguards are effective, we decline to adopt additional safeguards proposed by Americatel in this proceeding *See* Americatel Comments at 4-5

sharing prohibition will materially increase BOCs' abilities or incentives to misallocate costs or discriminate against unaffiliated rivals in price or performance. Nor will eliminating the prohibition diminish the ability of the Commission to monitor and enforce compliance with the Act in light of non-structural safeguards. Following elimination of the OI&M sharing prohibition, the Commission will be able to effectively monitor the performance of BOC provision of OI&M functions through application of (1) the other section 272 requirements and (2) the Commission's affiliate transactions and cost allocation rules.

19. We conclude that the remaining section 272 requirements, together with our other non-structural safeguards, will continue to serve as important and effective protections against anticompetitive conduct by BOCs following elimination of the OI&M sharing prohibition.[58] Because the requirements of section 272(b)(5)[59] continue to apply, the requirement to conduct all transactions at arm's length and disclose the details of such transactions on the Internet will apply to OI&M services.[60] Thus, elimination of the OI&M sharing prohibition would allow the section 272 affiliate to purchase OI&M services from the BOC, but the affiliate would purchase those services through a contract negotiated through arm's length dealing, and that contract would have to be reduced to writing and made publicly available In addition, the BOC would have an obligation under section 272(c)(1) to make those OI&M services, including both systems and personnel, available to unaffiliated rivals on a nondiscriminatory basis [61] Accordingly, any sharing of OI&M services between the BOC and the affiliate must be done in such a way that the provider stands ready to provide service to other entities. Moreover, a BOC's provision of exchange access services to its section 272 affiliate would continue to be subject to the nondiscrimination requirements of section 272(e).[62]

20. Further, after the OI&M sharing prohibition is eliminated, BOCs will continue to be obligated to maintain accounting procedures that protect against cross-subsidization of the section 272 affiliates by the BOCs' local customers.[63] We do not agree with opponents' assertions that the Commission's affiliate transaction and cost allocation rules are generally

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58 *See, e g*, Verizon Comments at 11-12, Verizon Reply at 14

59 47 U S C § 272(b)(5)

60 *See* 47 C F R § 53 203(e)

61 *See* 47 U S C § 272(c), (e)(2), (e)(4)

62 *See* 47 U S C § 272(e) BOCs will also remain fully subject to the remaining structural requirements of sections 272(b)(1)-(5) *See* n 28, *supra*.

63 *See* Qwest Comments at 7-8, Verizon Comments at 12, Qwest Reply at 10; Verizon Reply at 4 n 6. We note that these safeguards do not apply to transactions between affiliates However, as discussed above, the primary purpose of the rule prohibiting sharing between affiliates was to ensure that the prohibition against sharing between the BOC and the section 272 affiliate was not easily avoided Because we no longer prohibit sharing between a BOC and a section 272 affiliate, we no longer have concern that BOCs will use affiliates as a loophole around the sharing prohibition Because we did not impose the prohibition on affiliate-to-affiliate transactions due to a concern about cost misallocation between the affiliates, these transactions need not be included within these safeguards. *See* n 53, *supra*

inadequate to prevent cross-subsidization.[64] Those rules require, among other things, that the BOCs maintain cost allocation manuals (CAMs) that describe the nature, terms, and frequency of their affiliate transactions, describe their time reporting procedures, and set forth how they will allocate costs between their regulated and nonregulated activities.[65] Before being permitted to share OI&M services with their section 272 affiliates, we require BOCs to modify those manuals to address specifically any OI&M services that they share with their section 272 affiliates and to submit the amendments for Commission review Interested parties will have an opportunity to comment on those modifications according to our established procedures for CAM modifications.[66] The BOCs' internal processes for implementing their cost allocation manuals will be subject to the Commission's audit processes.

21 The provision of OI&M services will also be reviewed in the biennial audit required under section 272(d), and to the extent that an audit reveals problems, such as failure to comply with the affiliate transactions rules, the Commission could pursue appropriate enforcement action.[67] Section 272 audits are performed by independent auditors who review the BOCs' records, conduct interviews, and prepare audit reports. The Commission staff then reviews the audit reports to determine compliance with both the structural and non-structural requirements of section 272. To date, the independent auditors have completed and provided to Commission staff five audit reports, two concerning Verizon, two concerning SBC, and one concerning BellSouth The section 272 audit reports that have been concluded to date have identified certain compliance issues but generally have not disclosed systemic or significant issues warranting enforcement action.[68]

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64 *See, e.g*, AT&T Comments at 26-27, AT&T Reply at 19-21

65 *See* 47 C F R § 64 903(a)

66 CAM modifications are filed with the Commission for review and the Commission seeks public comment on the modifications If there is no opposition to the proposal, the Commission need not issue a written order approving the CAM proposal Rather, the CAM modifications will take effect unless suspended by the Bureau for a period not to exceed 180 days If the proposal is opposed or if the Commission identifies an issue with the proposal, the Commission or the Bureau will issue an order approving or rejecting the CAM proposal. *See* 47 C.F R. § 64 903(b)

67 47 U S C § 272(d)

68 The Commission did issue a Notice of Apparent Liability against Verizon concluding that Verizon had apparently violated section 220(d) of the Act and section 32.27 of our rules, which pertain to how the BOCs must account for affiliate transactions *See Verizon Telephone Companies, Inc Apparent Liability for Forfeiture*, File No EB-03-IH-0245, Notice of Apparent Liability for Forfeiture, 18 FCC Rcd 18796 (2003) (*Verizon NAL*) The *Verizon NAL* did not concern any OI&M issues Two recent audit reports have disclosed certain OI&M issues *See* BellSouth Section 272 Biennial Report on Agreed Upon Procedures for the Period May 24, 2002 to May 23, 2003 Prepared by PricewaterhouseCoopers, Appendix B 64-65 filed November 10, 2003 in EB Docket No 03-197, Verizon Section 272 Biennial Report on Agreed Upon Procedures for the Period January 3, 2001 to January 2, 2003 Prepared by PricewaterhouseCoopers, Appendix B 2-3 filed December 12, 2003 in EB Docket No 03-200 While we may consider enforcement action with respect to these issues, there is no indication that these instances represent systemic discrimination by the BOCs in favor of their long distance affiliates

22. With regard to cost allocation, BOCs assert that they have no incentive to misallocate costs under the current price cap regime in which sharing has been eliminated and the *CALLS* structure has been implemented.[69] They argue that the Commission, through these reforms, has severed all links between prices and costs, and, therefore, BOCs would gain no benefit from misallocating costs since this would not increase their prices or revenues.[70] On the other hand, opponents argue that, even under the current price cap system, the incentive remains for BOCs to subsidize their entry into the interLATA market.[71] We have already held that our price cap rules reduce incentives to cross-subsidize because prices are not directly based on accounting costs.[72] No party has submitted persuasive evidence that invalidates this conclusion. Because the price cap regime reduces incentives to misallocate costs, we conclude that the price cap rules together with the other non-structural safeguards discussed above, effectively limit BOCs' incentives and abilities to misallocate costs

23. Further, we reject AT&T's argument that the Commission's existing cost allocation rules would allow BOCs to misallocate costs between regulated and non-regulated activities.[73] Specifically, AT&T contends that BOCs would exploit the "prevailing price" cost allocation rule "to afford the affiliate all of the benefits of joint activities while bearing little or none of the resulting joint costs."[74] As AT&T notes, the Commission's rationale for allowing a

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[69] *See generally Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Low-Volume Long Distance Users, Federal-State Joint Board on Universal Service*, CC Docket Nos. 96-262, 94-1, 99-249, 96-45, Sixth Report and Order, Report and Order, Eleventh Report and Order, 15 FCC Rcd 12962 (2000) (*CALLS Order*) (subsequent history omitted), *see also id.* at 12969, para. 17 ("In the past, all or some price cap LECs were required to 'share,' or return to ratepayers, earnings above specified levels. This sharing requirement was eliminated in 1997.") (citing *Price Cap Performance Review for Local Exchange Carriers*, CC Docket Nos. 94-1, 96-262, Fourth Report and Order in CC Docket No. 94-1 and Second Report and Order in CC Docket No. 96-262, 12 FCC Rcd 16642, 16700 (1997), *aff'd in part, rev'd in part, USTA v. FCC*, 188 F.3d 521 (D.C. Cir. 1999))

[70] *See, e.g.*, BellSouth Comments at 9-10, Qwest Comments at 6-7; SBC Comments at 3, USTA Comments at 3, Verizon Comments at 8-9, BellSouth Reply at 4-9, Qwest Reply at 10; SBC Reply at 2, Verizon Reply at 12-13

[71] *See, e.g.*, Americatel Comments at 8-9, AT&T Comments at 23-26, Exh. A; Sprint Reply, Attach. 1 at 10-11, Attach. 2 at 6.

[72] *See Non-Accounting Safeguards Order*, 11 FCC Rcd at 21992, para. 181 ("We agree with commenters who contend that, in any event, federal price cap regulation reduces a BOC's incentives to allocate costs improperly.") (citations omitted), *CALLS Order*, 15 FCC Rcd at 12969, para. 17 ("Although price cap regulation eliminates the direct link between changes in allocated accounting costs and change in prices, it does not sever the connection between accounting costs and prices entirely."), *see also Verizon v. FCC*, 535 U.S. 467, 487 (2002) ("Although the price caps do not eliminate gamesmanship, since there are still battles to be fought over the productivity offset and allowable exogenous costs, they do give companies an incentive 'to improve productivity to the maximum extent possible,' by entitling those that outperform the productivity offset to keep resulting profits.") (citations omitted) One vestige of rate-of-return regulation that the price cap system retained – the low-end adjustment mechanism – has been eliminated for any price cap carriers exercising pricing flexibility. *See* 47 C.F.R. § 69.731. As a result, none of the BOCs may resort to the low-end adjustment, which would otherwise allow them to raise rates to target a 10.25% rate of return if they suffer low earnings

[73] *See* AT&T Comments, Declaration of Lee L. Selwyn, paras. 29-32 (AT&T Selwyn Decl.)

[74] AT&T Selwyn Decl., para. 30, *see* 47 C.F.R. § 32.27(d), *see also* Sprint Reply, Attach. 1 at 21. *But see* BellSouth Reply at 12-13

prevailing price allocation for transactions with a section 272 affiliate was that these transactions must be made available on a non-discriminatory basis to non-affiliated parties pursuant to sections 272(c)(1) and 272(e).[75] AT&T argues that the general availability of these services under section 272(c)(1) and 272(e) is no protection against cost misallocation in this situation because competitors are not likely to purchase OI&M services from a BOC.[76] We continue to believe that the availability of services on a non-discriminatory basis prevents BOCs from abusing the prevailing price rule. We cannot conclude on the basis of the record that all competitors would decline to contract with a BOC for OI&M services, particularly if a BOC were to attempt to engage in below cost pricing to its affiliate We also note that, beyond the accounting rules, the Act and the Commission's rules bar cross-subsidies between competitive and non-competitive services.[77] Therefore, we find that the OI&M sharing prohibition is not necessary to protect consumers and competitors from harms associated with misallocation of costs.[78] For all these reasons, we no longer conclude, as we did previously, that the sharing of personnel for OI&M would heighten the risk of improper cost allocation or preclude independent operation.

24. Finally, those opposed to eliminating the OI&M sharing prohibition allege that, if a BOC is allowed to share OI&M functions with its section 272 affiliate, it will increase the opportunities for performance discrimination and decrease the Commission's ability to monitor the BOC's performance in providing OI&M functions to itself and others.[79] We conclude, however, on the basis of the record, that the OI&M sharing prohibition is not a necessary tool for

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[75] *See* AT&T Selwyn Decl , para 30 (citing *Accounting Safeguards Order*, 11 FCC Rcd 17539, 17601, para 137)

[76] *See* AT&T Selwyn Decl., para 30 *But see* BellSouth Comments at 10-12, Verizon Comments at 10, Verizon Reply at 12 n.23, Letter from Brett A Kissel, Associate Director – Federal Regulatory, SBC, to Marlene H Dortch, Secretary, Federal Communications Commission, WC Docket No 03-228, Attach at 1 (filed Jan 21, 2004), Letter from Dee May, Vice President – Federal Regulatory, Verizon, to Marlene H Dortch, Secretary, Federal Communications Commission, WC Docket No 03-228 at 3-4 (filed Jan 23, 2004), Qwest Feb 4, 2004 *Ex Parte* Letter at 3-4 We note that, based on the record in this proceeding, it does not appear that AT&T has requested OI&M services from a BOC

[77] *See* 47 U S C § 254(k), 47 C F R § 64 901(c)

[78] On December 23, 2003, the Commission sought comment on a proposal by the Federal-State Joint Conference on Accounting to raise the qualification threshold for using the method of prevailing price valuation of affiliate transactions from 25 percent to 50 percent. The notice does not seek comment on the prevailing price rule as it applies to the section 272 transactions at issue here *See Federal-State Joint Conference on Accounting Issues, 2000 Biennial Regulatory Review – Comprehensive Review of the Accounting Requirements and ARMIS Reporting Requirements for Incumbent Local Exchange Carriers Phase II, Jurisdictional Separations Reforms and Referral to the Federal-State Joint Board, Local Competition and Broadband Reporting*, WC Docket No. 02-269, CC Docket Nos 00-199, 80-286, 99-301, Notice of Proposed Rulemaking, 18 FCC Rcd 26991, 26993-94, para 5 (2003), *see also* Letter from Federal-State Joint Conference on Accounting Issues, to Marlene H Dortch, Secretary, Federal Communications Commission, WC Docket No 02-269, Attach at 23-24 (filed Oct 9, 2003)

[79] *See* MCI Comments at 5-7, MCI Reply at 3-5, Sprint Reply, Attach 1 at 11-14, 20, Attach 2 at 8-9 *But see* BellSouth Comments at 10-12, Qwest Comment at 8-11, SBC Comments at 3 n 6, USTA Comments at 3, BellSouth Reply at 9-10, Qwest Reply at 11

detecting discrimination, and that non-structural alternatives are effective and efficient in detecting and deterring performance discrimination Sections 272(c)(1) and 272(e) will continue to prohibit discrimination against unaffiliated rivals.[80] In addition, because we acknowledge a relationship between our decision here and our outstanding Notice of Proposed Rulemaking on special access performance metrics, we commit to addressing special access performance metrics in that proceeding expeditiously.[81] Finally, section 272(d) audits, including the performance data reported as part of the audits, provide an effective mechanism for the Commission to detect, deter, and punish performance discrimination.[82] The Commission has enforcement authority to address allegations or complaints involving section 272 violations.[83] As discussed below, any additional benefit from the OI&M structural safeguards is outweighed by their significant costs, both operational costs, which are more readily quantifiable, and opportunity costs, which are more difficult to quantify. Moreover, we find that the record does not reflect that eliminating the OI&M sharing prohibition will increase BOCs' abilities or incentives to discriminate in the provisioning of access.

25. ***Costs of the OI&M Sharing Prohibition.*** We find that there is sufficient evidence in the record to show that the OI&M sharing prohibition has increased the section 272 affiliates' operating costs, and that the elimination of the OI&M sharing prohibition will likely result in substantial cost savings to the affiliates and enable the affiliates to compete more effectively in the interexchange market[84] We recognize that, at the time the OI&M sharing prohibition was adopted, the Commission acknowledged that structural separation may sacrifice economies of scale and scope[85] The Commission, nonetheless, concluded that the benefits of the OI&M sharing prohibition outweighed these costs We now find, however, that, when we

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[80] 47 U S C § 272(c)(1), (e)

[81] *See Performance Measurements and Standards for Interstate Special Access Services*, CC Docket No 01-321, Notice of Proposed Rulemaking, 16 FCC Rcd 20896 (2001), *see also, e g*, MCI Comments at 6-7; Sprint Comments, Attach 3 at 13, Attach 4 at 4, MCI Reply at 4-5 (urging the Commission to adopt special access performance metrics)

[82] 47 U S C § 272(d) We note that our rule change here is prospective only All audits for periods up to the effective date of this Order are still subject to the rules that existed during the time period covered by a particular audit

[83] *See, e g*, 47 U S.C §§ 208, 271(d)(6)

[84] *See* BellSouth Comments at 12-13, Letter from Mary L Henze, Assistant Vice President, Federal Regulatory, BellSouth, to Marlene Dortch, Secretary, Federal Communications Commission, WC Docket No 03-28 at 1 & Attach at 1-5 (filed Feb 3, 2003) (BellSouth Feb 3 *Ex Parte* Letter), Qwest Comments at 4, 11, Qwest Comments, Declaration of Rodney L Miller, paras 4-5 (Qwest Miller Decl), Qwest Comments, Declaration of Pamela J Stegora Axberg, paras 3-6 (Qwest Stegora Axberg Decl), SBC Petition at 20 & Attach 1, Declaration of Richard Deitz, paras 11-22 (SBC Deitz Decl), Verizon Comments at 19-23 & Attach 1, Verizon Petition, Declaration of Fred Howard, paras. 2-5 (Verizon Howard Decl); Verizon Comments, Attach 16, Verizon June 4 *Ex Parte* Letter (Verizon June 4 *Ex Parte* Letter), Verizon Comments, Attach 18 at 6-12 (Verizon June 24 *Ex Parte* Letter); Verizon Comments, Attach 19 at 4-6 (Verizon Aug. 11 *Ex Parte* Letter), Verizon Comments, Attach. 19, Supplemental Declaration of Fred Howard, paras 2-5 (Verizon Howard Supp Decl)

[85] *See, e.g , Non-Accounting Safeguards Order*, 11 FCC Rcd at 21911, 21913, paras. 7, 13, *Non-Accounting Safeguards Second Order on Reconsideration*, 12 FCC Rcd at 8683, para 55

consider the historical and projected costs of the OI&M sharing prohibition against protections afforded by our structural and non-structural safeguards, the costs of the rule exceed the likely benefits of maintaining the rule. Moreover, we find that the likely savings to the section 272 affiliates by elimination of the rule, in conjunction with the BOCs' adherence to our structural and non-structural rules, including the cost allocation rules, supports a finding for the elimination of the OI&M sharing prohibition at this time.

26. The estimates of the projected savings from relief of the OI&M sharing prohibition vary across the BOCs. The BOCs' estimates of their individual annual savings from the elimination of the OI&M sharing prohibition range from $2 million to $46 million [86] The estimated savings from the elimination of the OI&M sharing prohibition may vary according to the BOC's particular business decision as to how to structure its section 272 affiliate and how OI&M is provisioned by the affiliate.[87] In addition, there are numerous factors that could affect the estimates of cost savings reaped by elimination of the OI&M sharing prohibition, including but not limited to the length of time to the sunset of the last separate affiliate,[88] the number of customers and the volume of traffic served by the section 272 affiliate,[89] and the time horizon and method in which the affiliate's OI&M functions are integrated into the BOC [90] Commenters

[86] *See* Bellsouth Comments at 4-5; BellSouth Feb 3 *Ex Parte* Letter, Attach at 5 Qwest estimates that it could save approximately $20 million in OI&M activities in 2004 if it and its Section 272 affiliate were permitted to share OI&M functions *See* Qwest Comments at 4, 11; Qwest Miller Decl , paras 4-5, Qwest Stegora Axberg Decl., paras 3-6 Verizon's Global Networks Inc (GNI) is Verizon's section 272 affiliate that provides OI&M services to its other affiliates Verizon estimates that GNI would save approximately $183 million from 2003 to 2006 ($45 6 million per year) *See* Verizon Comments at 20. SBC estimates annual saving of $78 million, but this estimate is from integrating its section 272 affiliates, ASI, and its other data services affiliates, rather than from integrating its section 272 affiliates into its BOCs *See* SBC Comments at 2-3, SBC Deitz Decl , para 11.

[87] *See* BellSouth Comments at 12-14, MCI Comments at 5, Qwest Comments at 11, AT&T Reply at 3, 11 For example, BellSouth's section 272 affiliate made a business decision to lease facilities and to outsource more of the OI&M functions than the other BOC section 272 affiliates. *See* BellSouth Comments at 12-13

[88] There are significant differences in the time horizon from the present to end of the third year from the date of each BOC's last section 271 approval BellSouth approximately 21 months (12/05), Qwest approximately 33 months (12/06), Verizon approximately 24 months (3/06); SBC approximately 31 months (10/06). *See* FCC, *RBOC Applications to Provide In-region, InterLATA Services Under § 271* (visited Mar. 11, 2004) <http://www fcc.gov/Bureaus/Common_Carrier/in-region_applications/>

[89] *See* Verizon June 24 *Ex Parte* Letter, Attach 1 at 9-10 As of the fourth quarter of 2003, Verizon had 16.6 million long distance lines, SBC had 14 4 million long distance lines, BellSouth had approximately 4 million long distance customers, and Qwest had 2.3 million long distance customers *See* Verizon, *Verizon Reports Solid Overall Fourth-Quarter and Year-End Results, Based on Strong Fundamentals*, Press Release (Jan. 29, 2004), SBC, *SBC Reports Strong 4th-Quarter Long Distance Launch in Midwest, Improved Retail Access Line Trends, Record Gains in Long Distance, DSL*, Press Release (Jan 27, 2004), BellSouth, *BellSouth Reports Fourth Quarter Earnings*, Press Release (Jan 22, 2004), Qwest, *Qwest Communications Reports Fourth Quarter 2003 Net Loss Per Diluted Share of $0 17, Full Year 2003 Earnings Per Diluted Share of $0 93*, Press Release (Feb 19, 2004)

[90] For example, while Verizon's estimates assume a three-year phase in to integrate GNI's OI&M functions into the BOC, Verizon's analysis attempts to minimize the abandonment of sunk investments and the costs to integrate GNI's and the BOC's OI&M operations. *See* Verizon Comments at 15 n. 22, Verizon June 4 *Ex Parte* Letter, Attach 3 at 1, 4-6, Verizon June 24 *Ex Parte* Letter, Attach 1 at 11-12, *see also* BellSouth Feb. 3 *Ex Parte* Letter at 1 & Attach at 2-3

make three primary criticisms of the cost estimates of the OI&M sharing prohibition: (1) there is insufficient evidence to substantiate the cost savings estimates;[91] (2) the Commission should consider whether cost savings could be achieved by the BOCs' restructuring of their affiliate structures or by contracting with other service providers;[92] and (3) there is no guarantee any savings will be passed on to consumers.[93] We discuss these criticisms in turn

27. The Commission has previously found that structural separation may sacrifice economies of scale and scope [94] We find that sufficient evidence is in this record to support the contention that the OI&M sharing prohibition significantly increases the BOCs' respective section 272 affiliate's costs and that substantial savings could be reaped by the BOCs if the OI&M sharing prohibition is lifted.[95] The record evidence submitted by the BOCs provides a reasonable basis for the Commission to assess the existence and likely magnitude of future cost savings. In addition, AT&T argues that, because each BOC has chosen a different affiliate structure, any costs above the lowest BOC estimate of costs for maintaining structurally separate OI&M services should be summarily discounted. AT&T contends that we should not weigh costs that BOCs incur as a result of their own choices to adopt more costly affiliate structures. We reject AT&T's assertion that the Commission consider the potential savings the BOC affiliates could reap by altering their affiliate structure or by contracting with other service providers rather than the BOC for OI&M services We believe that this would amount to second-guessing by the Commission of a normal business decision. BOCs may have legitimate business reasons for ac pting a particular structure or choosing to outsource. AT&T would have us focus on whether any number of hypothetical alternatives could be used rather than on the costs and benefits of the rule at issue and we do not believe such a focus is appropriate.

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91 *See* AT&T Reply at 3, 13-14, AT&T Comments, Exh A, AT&T Opposition at 3, 12-13 (AT&T Opposition), AT&T Opposition, Reply Declaration of Lee Selwyn, paras 26-27 (AT&T Selwyn Reply Decl), AT&T Comments, Exh B, at 16-20 (AT&T Reply to SBC Petition), AT&T Comments, Exh E, at 5-6 (AT&T Nov 15 *Ex Parte* Letter), AT&T Comments, Exh. F, paras 3-6 (AT&T Selwyn Nov 15 *Ex Parte* Decl.), AT&T Comments, Exh G at 3-4 (AT&T July 9 *Ex Parte* Letter), AT&T Comments, Exh. H, paras 3-4 (AT&T Selwyn July 9 *Ex Parte* Decl), AT&T Comments, Exh J at 2-3 (AT&T Oct 1 *Ex Parte* Letter), MCI Reply at 5-6, Sprint Reply, Attach 1, at 15, 22, Sprint Reply, Attach 2 at 10

92 *See* AT&T Comments, Attach. J at 6 (AT&T Oct 1 *Ex Parte* Letter), AT&T Reply at 3, 11-13.

93 *See* AT&T Nov 15 *Ex Parte* Letter at 7, AT&T Selwyn Nov 15 *Ex Parte* Decl., para. 8

94 *See, e g , Non-Accounting Safeguards Order*, 11 FCC Rcd at 21911, 21913, paras. 7, 13, *Non-Accounting Safeguards Second Order on Reconsideration*, 12 FCC Rcd at 8683, para. 55

95 *See* n 84, *supra* We find that the savings the BOCs will likely attain from the elimination of the OI&M sharing prohibition are sufficient such that they will exceed any benefits from maintaining this rule, while also maintaining the other requirements of section 272(b)(1) *See* para 31, *infra* Moreover, we reject AT&T's criticism that Verizon's analysis neglects to consider the costs to integrate the BOC's and GNI's OI&M functions because Verizon asserts its methodology specifically sought to minimize these costs Verizon's analysis does not assume a flash cut to fully integrate the BOC's and GNI's OI&M operations, but rather assumes GNI phases in organizational changes over time to take full advantage of attrition during the transition period and to avoid the write off of sunk investments due to the Commission's separate affiliate rules *See* Verizon June 24 *Ex Parte* Letter, Attach at 11-13

28 Finally, we disagree that savings reaped by the section 272 affiliates are unlikely to be passed on to consumers in the long distance market [96] The Commission has found, and AT&T has acknowledged that the long distance market is substantially competitive.[97] In a competitive market, it is likely that the savings in additional costs will be passed on to their long distance consumers [98] We note that if a BOC failed to pass along savings, it would be less competitive in the long distance market vis-à-vis other providers of stand-alone long distance services

29. We further find that the evidence supports BOCs' claims that the OI&M sharing prohibition imposes inefficiencies that prevent BOCs from competing more effectively in the interexchange market [99] BOCs argue that the OI&M sharing prohibition creates an unnecessary regulatory barrier and imposes unnecessary opportunity costs by preventing them from providing end-to-end services, especially for large business customers, at the same quality as their interLATA competitors [100] For example, Verizon claims that the OI&M sharing prohibition requires "handoffs of customer requests for service and repair that add cost and difficulty in meeting customer expectations."[101] If the OI&M sharing prohibition were eliminated, BOCs state, they would gain greater flexibility to provide integrated service offerings that cut across traditional interLATA and intraLATA boundaries, including broadband and advanced services [102] Further, the BOCs argue that, because there is no legal prohibition against competitors providing end-to-end services on an integrated basis, the OI&M sharing prohibition puts BOCs at a

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96 *See* AT&T Nov 15 *Ex Parte* Letter at 7, AT&T Selwyn Nov 15 *Ex Parte* Decl., para 8

97 *See, e g , Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area, Policy and Rules Concerning the Interstate, Interexchange Marketplace*, CC Docket Nos. 96-149, 96-61, Second Report and Order in CC Docket No. 96-149, Third Report and Order in CC Docket No 96-61, 12 FCC Rcd 15756, 15805, para 86 (1997) ("Because we previously have found that markets for long distance services are substantially competitive in most areas, marketplace forces should effectively deter carriers that face competition from engaging in the practices that Congress sought to address through the section 214 requirements "), *see* AT&T Opposition to Petition at 16 n 12

98 *See generally* Edgar Browning & Jacqueline Browning, *Microeconomic Theory and Applications* 340-49 (2d ed. 1986)

99 *See Non-Accounting Safeguards Order*, 11 FCC Rcd at 21981, para 156 (stating that the Commission's task was "to implement section 272 in a manner that ensures that the fundamental goal of the 1996 Act is attained – to open all telecommunications markets to robust competition – but at the same time does not impose requirements on the BOCs that will unfairly handicap them in their ability to compete.")

100 *See* Qwest Comments at 11-15, Qwest Stegora Axberg Decl , para. 6 ("The benefits to Qwest's interLATA customers from elimination of the OI&M restrictions are even more important that the direct cost savings to Qwest."), SBC Comments at 2-3, USTA Comments at 4 Opportunity cost is the value of a foregone alternative action Thus, the OI&M sharing prohibition imposes opportunity costs that include the foregone services that could have been provided in the absence of the prohibition *See The MIT Dictionary of Modern Economics* 315 (David W Pearce ed , 4th ed. 1996)

101 Verizon Comments, Attach 1, Declaration of Steven G McCully, para 4

102 *See* BellSouth Comments at 6-8, 13-14, Qwest Comments at 14-15, Verizon Comments at 16, Verizon Reply at 17-18

competitive disadvantage.[103] In response, BOC competitors argue that this is exactly the type of coordination that they must perform for their customers given that they rely heavily on BOC last-mile facilities. As a result, they contend that the OI&M sharing prohibition merely "levels the playing field" and that eliminating the rules would put competitors at an unfair competitive disadvantage [104]

30. As discussed above, to the extent that the section 272 affiliate contracts with the BOC for OI&M services, these services must be provided to unaffiliated carriers on a nondiscriminatory basis pursuant to sections 272(c)(1) and 272(e). Therefore, we conclude that the Act and our rules will prevent BOCs from gaining any undue advantage. Further, we are persuaded that consumers will likely benefit from increased competition based on quality of service We also agree with BOCs that cost savings should allow them to compete more effectively with their rivals in the interLATA market, particularly for customers desiring highly-customized service bundles such as large enterprise customers, because they will have increased opportunities to obtain convenient, competitively priced interLATA services. As we explained above, the elimination of the OI&M sharing prohibition does not remove all protections against discrimination.

31. On the basis of these findings, we conclude that the OI&M sharing prohibition poses significant adverse consequences – in terms of costs and competition in interLATA services market – that outweigh any potential benefits of enforcing structural separation of OI&M services, given the protections afforded to consumers and competitors by our non-structural safeguards. We find that the OI&M sharing prohibition is an overbroad means of eliminating the risk of cost misallocation and discrimination in today's market. For these reasons, we eliminate the OI&M sharing prohibition [105] As noted above, we require BOCs to modify their CAMs to address specifically any OI&M services that they intend to provide their section 272 affiliates and to submit the amendments for Commission review

C. Joint Facilities Ownership

32. The joint facilities ownership restriction was adopted concurrently with the OI&M sharing prohibition to implement the "operate independently" requirement of section 272(b)(1) [106]

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[103] *See* BellSouth Comments at 5, SBC Comments at 3, USTA Comments at 4, Verizon Comments at 14, BellSouth Reply at 14, SBC Reply at 2 n 2, Verizon Reply at 16-17

[104] *See* Americatel Comments at 7-8, AT&T Comments at 28, MCI Comments at 5, AT&T Reply at 14-17, MCI Reply at 2-3, 6-7, Sprint Reply, Attach 1 at 18-20, Attach 2 at 13-14

[105] We note that this holding applies to all interLATA telecommunications services provided pursuant to section 272 These services include both interstate and intrastate interLATA services Therefore, we affirm the Commission's conclusion in the *Non-Accounting Safeguards Order* that "the rules we establish to implement section 272 are binding on the states, and the states may not impose, with respect to BOC provision of intrastate interLATA service, requirements inconsistent with sections 271 and 272 and the Commission's rules under those provisions." *Non-Accounting Safeguards Order*, 11 FCC Rcd at 21929, para 47, *see* SBC Comments at 5-6

[106] *See Non-Accounting Safeguards Order*, 11 FCC Rcd at 21981-84, paras 158-62

The joint facilities ownership restriction, codified in section 53 203(a)(1) of the Commission's rules, provides that "[a] section 272 affiliate and the BOC of which it is an affiliate shall not jointly own transmission and switching facilities or the land and buildings where those facilities are located."[107] In adopting this restriction, the Commission believed that joint ownership of facilities could facilitate cost misallocation and discrimination. Based on the record presented in this proceeding, we continue to believe that, unlike the OI&M sharing prohibition, the costs of maintaining separate ownership of facilities do not outweigh the benefits the rule provides against cost misallocation and discrimination.[108] For example, based on the record, we are persuaded that shared facilities would likely create significant joint and common costs that would be inherently difficult to allocate properly.[109] In making this determination, we are mindful that the record support for eliminating the joint facilities ownership restriction is much more limited and inconclusive than the record that has been presented on the OI&M sharing prohibition.[110] Therefore, we retain the joint facilities ownership restriction to ensure that BOCs and their affiliates continue to "operate independently."

D. Other Issues

33. ***The SBC/Ameritech Merger Order and the SBC Advanced Services Forbearance Order.*** In the SBC Petition, SBC requested that the Commission (1) modify Condition I of the *SBC/Ameritech Merger Order* to eliminate the OI&M sharing restriction; and (2) clarify that the modification of the condition would not affect the relief granted in the *SBC Advanced Services Forbearance Order*.[111] In the *SBC Advanced Services Forbearance Order*, the Commission conditioned its finding that SBC satisfied the statutory criteria for forbearance upon, among others, the condition that "SBC operates in accordance with the separate affiliate structure established" in the *SBC/Ameritech Merger Order*. In turn, the *SBC/Ameritech Merger Order* Condition I imposed restrictions on the sharing of OI&M services between the advanced services affiliate and the BOC or other affiliates. Under the merger condition, SBC was required to operate its advanced services affiliate in accordance with requirements governing interexchange affiliates under section 272, including section 272(b), with certain exceptions, as interpreted by the Commission as of August 27, 1999.[112] Therefore, SBC seeks modification of the merger condition and clarification of the forbearance order because elimination of the OI&M sharing prohibition in the Commission's rules would not automatically eliminate the OI&M restrictions in the conditions of these orders. SBC argues that, for the same reasons that the

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107 47 C.F.R. § 53.203(a)(1)

108 *See, e.g.*, Americatel Comments at 9-13, AT&T Comments at 10-21; AT&T Reply at 4-7

109 *See, e.g.*, AT&T Comments at 17

110 *See, e.g.*, Americatel Comments at 9-13, AT&T Comments at 10-21, BellSouth Comments at 14-16, Qwest Comments at 13, SBC Comments at 6, USTA Comments at 4, AT&T Reply at 4-7, BellSouth Reply at 15-17, SBC Reply at 3-7

111 *See* SBC Petition at 25-27

112 *See SBC/Ameritech Merger Order*, 14 FCC Rcd at 14969-74, Condition I.3

OI&M sharing prohibition should be eliminated under section 272(b)(1), the Commission should eliminate the OI&M restriction in these conditions.

34. In this Order, we grant SBC's request that we modify the *SBC/Ameritech Merger Order* condition regarding OI&M sharing between the advanced services affiliate and the BOC or other affiliates as it has been incorporated through the *SBC Advanced Services Forbearance Order*. Specifically, we modify the *SBC Advanced Services Forbearance Order* to the extent that the separate affiliate condition of the forbearance granted in that Order included the OI&M restriction contained in the *SBC/Ameritech Merger Order*.[113] AT&T and Sprint oppose the relief from these conditions sought by SBC [114] For example, with regard to the *SBC Advanced Services Forbearance Order*, AT&T argues that, "if the Commission were to waive any aspect of the advanced services separate affiliate requirement imposed in the *SBC/Ameritech Merger Order*, SBC would no longer" be complying with the separate affiliate condition of forbearance.[115] Further, AT&T argues that the Commission expressly rejected SBC's arguments in favor of lesser safeguards as a forbearance condition [116]

35. For reasons consistent with those discussed above with regard to section 272(b)(1)'s OI&M sharing prohibition and the reasons discussed in the *SBC Advanced Services Forbearance Order*, we are persuaded that we should also eliminate the OI&M restriction to the extent that it is a condition of forbearance granted in the *SBC Advanced Services Forbearance Order* The OI&M restriction adopted in the *SBC/Ameritech Merger Order* was implemented to guard against the same potential anticompetitive conduct by the merged entity that the OI&M sharing prohibition under our rules was designed to prevent in the context of section 272 affiliates. Indeed, the OI&M restriction for the advanced services affiliate under the merger order was less restrictive than the OI&M sharing prohibition for section 272 affiliates. Specifically, the merger condition expressly allowed the BOC to provide OI&M services to the advanced services affiliate, which was prohibited under the rules for section 272 affiliates.[117] In this Order, we eliminate the more onerous rules for section 272 affiliates We conclude that it would be inconsistent to eliminate the OI&M sharing prohibition in our rules but maintain the lesser OI&M restriction as a condition of forbearance when the condition rested on parallel analysis of the risks of anticompetitive conduct. Because we conclude that the costs outweigh the benefits of the OI&M sharing prohibition, the costs of the OI&M forbearance condition must logically outweigh its benefits.[118]

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113 *See SBC Advanced Services Forbearance Order*, 17 FCC Rcd at 27003, 27008, paras 5, 13

114 *See* AT&T Comments, CC Docket Nos 96-149, 98-141 at 12-16 (filed July 1, 2003) (AT&T Merger Modification Comments), Sprint Comments, CC Docket 98-141 at 1-2 (filed July 1, 2003)

115 AT&T Merger Modification Comments at 14

116 *See id*

117 *See SBC/Ameritech Merger Order*, 14 FCC Rcd at 14860-61, paras 364-65

118 We note that this modification is necessary to allow SBC to realize fully the benefits of eliminating the OI&M sharing prohibition

36. We further conclude that eliminating the OI&M restriction from the separate affiliate forbearance condition does not alter the outcome of our forbearance analysis First, we find that, even without the OI&M restriction, the application of tariff regulation to SBC's advanced services operations is not necessary to ensure that "charges, practices, classifications, or regulations are just and reasonable and are not unjustly or unreasonably discriminatory."[119] Because SBC and ASI will be required to comply with all other conditions, including the affiliate transactions rules and nondiscrimination requirements, we conclude that the separate affiliate structure without the OI&M restriction will serve the purposes the Commission envisaged in the *SBC Advanced Services Forbearance Order*, and therefore, tariff regulation is not necessary within the meaning of the first forbearance criterion. Second, we find that application of tariff regulation to SBC's advanced services operations is not necessary to ensure the protection of consumers,[120] to the extent that SBC complies with all conditions outlined in the *SBC Advanced Services Forbearance Order* other than the OI&M restriction. We continue to believe that the separate affiliate structure will safeguard consumers' interests within the meaning of the second forbearance criterion, and indeed, we expect consumers to benefit from increased competition based on quality of service and resulting from efficiency gains in SBC's operations Third, we find that, without the OI&M restriction, forbearance from applying the tariff requirements to SBC's advanced services operations will continue to be consistent with the public interest to the extent that SBC complies with all other conditions.[121] Specifically, we conclude that, by allowing ASI to compete more effectively based on quality of service and improved efficiency, forbearance "will promote competitive market conditions," including "enhance[d] competition among providers of telecommunications services."[122]

37. We recognize, as AT&T notes, that the Commission rejected SBC's arguments that "lesser safeguards would suffice in the event it were to change its affiliate structure and ways of dealing with its advanced services customers."[123] The Commission, however, rejected SBC's argument in the context of a unilateral change to the affiliate structure made by SBC By contrast, here, we, not SBC, are adopting a change to the conditions after full notice, comment, and consideration of the underlying issues. Moreover, the Commission expressly stated that it was considering only SBC's affiliate structure as it existed at that time and would not consider various hypothetical structures.[124] The Commission did not conduct a forbearance analysis with regard to the separate affiliate structure under consideration here, specifically a structure that continues to comply with all other conditions of forbearance with the sole exception of the OI&M restriction. Here, we have applied the forbearance criteria to the structure presented in the SBC Petition, and we find that SBC continues to satisfy the statutory criteria for forbearance

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119 47 U S C § 160(a)(1)

120 *See* 47 U S C § 160(a)(2)

121 *See* 47 U S C § 160(a)(3)

122 47 U S C § 160(b)

123 *SBC Advanced Services Forbearance Order*, 17 FCC Rcd at 27016-17, para. 30

124 *See SBC Advanced Services Forbearance Order*, 17 FCC Rcd at 27008, para 13

from the tariff requirement to the extent that it complies with all remaining conditions of the *SBC Advanced Services Forbearance Order* We emphasize that this modification does not affect in any way other conditions in the *SBC Advanced Services Forbearance Order* and SBC must continue to comply fully with those conditions in order to continue to enjoy the relief granted in that order

38. ***SBC and BellSouth Forbearance Petitions.*** Finally, we dismiss the forbearance petitions filed by SBC and BellSouth seeking forbearance from the OI&M sharing prohibition because the petitions are moot in light of the action we take in this Order [125] Specifically, SBC and BellSouth sought forbearance from the application of the OI&M sharing prohibition, sections 53.203(a)(2)-(3) of the Commission's rules. In this Order, we eliminate those rules Because SBC's and BellSouth's petitions seek forbearance from rules that will no longer exist, their petitions are moot.

IV. CONCLUSION

39. For the reasons discussed above, we conclude that the OI&M sharing prohibition is not a necessary component of the statutory requirement to "operate independently" and is an overbroad means of preventing cost misallocation or discrimination by BOCs against unaffiliated rivals. Therefore, we hereby eliminate sections 53.203(a)(2)-(3) of the Commission's rules. We further conclude that we should retain the prohibition against joint ownership by BOCs and their section 272 affiliates of switching and transmission facilities, or the land and buildings on which such facilities are located In addition, we dismiss petitions filed by SBC and BellSouth seeking forbearance from the OI&M sharing prohibition Finally, we grant SBC's request for modification of the *SBC/Ameritech Merger Order* conditions related to OI&M services to the extent that these merger conditions are incorporated into the conditions of the *SBC Advanced Services Forbearance Order*.[126]

V. PROCEDURAL MATTERS

A. Final Regulatory Flexibility Certification

40. The Regulatory Flexibility Act of 1980, as amended (RFA),[127] requires that a regulatory flexibility analysis be prepared for notice-and-comment rulemaking proceedings, unless the agency certifies that "the rule will not, if promulgated, have a significant economic impact on a substantial number of small entities."[128] The RFA generally defines the term "small

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[125] *See generally* SBC Petition, BellSouth Petition As noted above, the Bureau has already dismissed Qwest's forbearance petition *See* n 21, *supra*

[126] Pursuant to sections 1 103(a) and 1 427(b) of the Commission's rules, we find good cause for this Order to be effective upon publication in the Federal Register because the Order relieves restrictions upon carriers under our existing rules *See* 47 C F R. §§ 1 103(a), 1 427(b)

[127] *See* 5 U S C § 603 The RFA, *see* 5 U.S.C §§ 601-12, has been amended by the Small Business Regulatory Enforcement Fairness Act of 1996 (SBREFA), Pub L No 104-121, Title II, 110 Stat 857 (1996)

[128] 5 U S C § 605(b)

entity" as having the same meaning as the terms "small business," "small organization," and "small governmental jurisdiction."[129] In addition, the term "small business" has the same meaning as the term "small business concern" under the Small Business Act.[130] A "small business concern" is one which: (1) is independently owned and operated; (2) is not dominant in its field of operation, and (3) satisfies any additional criteria established by the Small Business Administration (SBA).[131]

41. In the *Notice*, we sought comment generally on whether we should modify or eliminate the rules adopted to implement the "operate independently" requirement of section 272(b)(1) of the Act.[132] Specifically, we sought comment on whether the OI&M sharing prohibition is an overbroad means of preventing cost misallocation or discrimination by BOCs against unaffiliated rivals.[133] We also sought comment on whether the prohibition against joint ownership by BOCs and their section 272 affiliates of switching and transmission facilities, or the land and buildings on which such facilities are located, should be modified or eliminated.[134]

42. The Order eliminates the OI&M sharing prohibition, under sections 53 203(a)(2)-(3) of the Commission's rules, because the Commission finds that it is an overbroad means of preventing cost misallocation or discrimination by BOCs against unaffiliated rivals.[135] Further, the Order retains the prohibition against joint ownership by BOCs and their section 272 affiliates of switching and transmission facilities, or the land and buildings on which such facilities are located, under sections 53.203(a)(1) of the Commission's rules.[136]

43 The rules adopted in this Order apply only to BOCs and their section 272 affiliates. Neither the Commission nor the SBA has developed a small business size standard specifically applicable to providers of incumbent local exchange service and interexchange services. The closest applicable size standard under the SBA rules is for Wired Telecommunications Carriers.[137] This provides that such a carrier is small entity if it employs no more than 1,500 employees.[138] None of the four BOCs that would be affected by amendment of

129 5 U S C § 601(6)

130 5 U S C § 601(3) (incorporating by reference the definition of "small-business concern" in the Small Business Act, 15 U.S C § 632) Pursuant to 5 U S.C. § 601(3), the statutory definition of a small business applies "unless an agency, after consultation with the Office of Advocacy of the Small Business Administration and after opportunity for public comment, establishes one or more definitions of such term which are appropriate to the activities of the agency and publishes such definition(s) in the Federal Register "

131 15 U S C § 632

132 47 U S C. § 272(b)(1)

133 47 C F R § 53 203(a)(2)-(3)

134 47 C F R § 53.203(a)(1)

135 47 C F R § 53 203(a)(2)-(3)

136 47 C F R § 53 203(a)(1)

137 13 C F R § 121 201, NAICS code 517110

138 *Id*

these rules meets this standard We next turn to whether any of the section 272 affiliates may be deemed a small entity Under SBA regulation 121.103(a)(4), "SBA counts the ... employees of the concern whose size is at issue and those of all its domestic and foreign affiliates .. in determining the concern's size."[139] In that regard, we note that, although section 272 affiliates operate independently from their affiliated BOCs, many are 50 percent or more owned by their respective BOCs, and thus would not qualify as small entities under the applicable SBA regulation [140] Moreover, even if the section 272 affiliates were not "affiliates" of BOCs, as defined by SBA, as many are, the Commission estimates that fewer than fifteen section 272 affiliates would fall below the size threshold of 1,500 employees. Particularly in light of the fact that Commission data indicate that a total of 261 companies have reported that their primary telecommunications service activity is the provision of interexchange services,[141] the fifteen section 272 affiliates that may be small entities do not constitute a "substantial number." Because the rule amendments directly affect only BOCs and section 272 affiliates, based on the foregoing, we conclude that a substantial number of small entities will not be affected by the rules

44 Therefore, we certify that the requirements of the Order will not have a significant economic impact on a substantial number of small entities.

45. The Commission will send a copy of the Order, including a copy of this Final Regulatory Flexibility Certification, in a report to Congress pursuant to the Congressional Review Act [142] In addition, the Order and this final certification will be sent to the Chief Counsel for Advocacy of the SBA, and will be published in the Federal Register [143]

B. Final Paperwork Reduction Act Analysis

46 This Report and Order does not contain information collection(s) subject to the Paperwork Reduction Act of 1995 (PRA), Public Law 104-13.

VI. ORDERING CLAUSES

47 IT IS ORDERED that, pursuant to sections 2, 4(i)-(j), 272, and 303(r) of the Communications Act of 1934, as amended, 47 U.S.C. §§ 152, 154(i)-(j), 272, 303(r), the Report and Order IS ADOPTED.

48 IT IS FURTHER ORDERED, pursuant to sections 4(i), 10, 272, and 303(r) of the Communications Act of 1934, as amended, 47 U S.C. §§ 154(i), 160, 272, 303(r), that the

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139 13 C F.R. § 121 103(a)(4)

140 *See* 13 C F R. § 121 103(c)

141 *See* FCC, Wireline Competition Bureau, Industry Analysis and Technology Division, *Trends in Telephone Service* at Table 5 3, page 5-5 (Aug 2003) This source uses data that are current as of December 31, 2001

142 *See* 5 U S C § 801(a)(1)(A)

143 *See* 5 U S C § 605(b)

petitions for forbearance filed by BellSouth and SBC with respect to their operating, installation, and maintenance functions ARE DISMISSED as moot

49. IT IS FURTHER ORDERED, pursuant to sections 4(i), 4(j), 214(a), 214(c), 309, and 310(d) of the Communications Act of 1934, as amended, 47 U.S C §§ 154(i), 154(j), 214(a), 214(c), 309, 310(d), that the petition for modification of the *SBC/Ameritech Merger Order* filed by SBC IS GRANTED to the extent stated herein

50 IT IS FURTHER ORDERED, pursuant to sections 1.103(a) and 1 427(b) of the Commission's rules, 47 C F R. §§ 1.103(a), 1 427(b), that this Report and Order and Memorandum Opinion and Order SHALL BE EFFECTIVE upon publication of the Report and Order in the FEDERAL REGISTER.

51. IT IS FURTHER ORDERED that the Commission's Consumer and Governmental Affairs Bureau, Reference Information Center, SHALL SEND a copy of this Order, including the Final Regulatory Flexibility Certification, to the Chief Counsel for Advocacy of the Small Business Administration.

FEDERAL COMMUNICATIONS COMMISSION

Marlene H. Dortch
Secretary

APPENDIX – FINAL RULES

PART 53 of Title 47 of the Code of Federal Regulations is amended as follows:

PART 53 – SPECIAL PROVISIONS CONCERNING BELL OPERATING COMPANIES

1. Section 53 203 is amended by removing paragraphs (a)(2) and (a)(3), and redesignating paragraph (a)(1) as paragraph (a) as follows

§ 53.203 Structural and transactional requirements.

(a) *Operational independence.* A section 272 affiliate and the BOC of which it is an affiliate shall not jointly own transmission and switching facilities or the land and buildings where those facilities are located

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SEPARATE STATEMENT OF CHAIRMAN MICHAEL K. POWELL

Re *Section 272(b)(1)'s "Operate Independently" Requirement for Section 272 Affiliates, Petition of SBC for Forbearance from the Prohibition of Sharing Operating, Installation, and Maintenance Functions under Sections 53.203(a)(2) and 53 203(a)(3) of the Commission's Rules and Modification of Operating, Installation, and Maintenance Conditions Contained in the SBC/Ameritech Merger Order, Petition of BellSouth Corporation for Forbearance from the Prohibition of Sharing Operating, Installation, and Maintenance Functions Under Section 53 203(a)(2)-(3) of the Commission's Rules, Review of Regulatory Requirements for Incumbent LEC Broadband Telecommunications Services, Report and Order in WC Docket No 03-228, Memorandum Opinion and Order in CC Docket Nos 96-149, 98-141, 01-337*

Regulators bear an important obligation to retire rules that no longer serve their intended purpose. Today's Order is faithful to that charge. This item eliminates the unnecessary and costly prohibition on certain types of sharing between Bell operating companies (BOCs) and their separate affiliates.[1] In this instance, the items find the costs of prohibiting BOCs from sharing operations, installation and maintenance (OI&M) now outweigh the purported benefits Moreover, other, less intrusive rules already minimize the risk of discrimination and cost misallocation by the BOCs As a result, the time for requiring the prohibition on OI&M sharing has passed

Significantly, today's order does not represent an exercise of our forbearance authority Instead, the Commission has fulfilled its obligation to reexamine the Communications Act in light of our experience and marketplace changes. While I am pleased that the Commission has acted, I also believe that this Commission could have achieved this pro-competitive result through the use of our forbearance authority. Indeed, as Commissioner Abernathy rightly points out, a forbearance approach would have avoided any tension between today's action and past Commission Orders on this subject. Nonetheless, I am pleased that the Commission has moved to update our rules and appreciate the support of my colleagues in this proceeding. Consumers benefit when providers can direct resources away from complying with unnecessary regulations and toward competing in the marketplace

[1] 47 C F R § 53 203(a)(2)-(3).

SEPARATE STATEMENT OF COMMISSIONER KATHLEEN Q. ABERNATHY

Re: Section 272(b)(1)'s "Operate Independently" Requirement for Section 272 Affiliates, Petition of SBC for Forbearance from the Prohibition of Sharing Operating, Installation, and Maintenance Functions Under Sections 53 203(a)(2) and 53.203(a)(3) of the Commission's Rules and Modification of Operating, Installation, and Maintenance Conditions Contained in the SBC/Ameritech Merger Order, Petition of BellSouth Corp for Forbearance from the Prohibition of Sharing Operating, Installation, and Maintenance Functions Under Section 53.203(a)(2)-(3) of the Commission's Rules, Review of Regulatory Requirements for Incumbent LEC Broadband Telecommunications Services, Report and Order and Memorandum Opinion and Order

I support the Commission's decision to eliminate the prohibition on the sharing of operating, installation, and maintenance functions by Bell operating companies and their affiliates (the "OI&M rule") I believe the costs of the OI&M rule clearly outweigh its benefits If the Bell companies are going compete effectively in the market for long-distance services, including enterprise broadband services, they cannot be required to duplicate functions unnecessarily. The OI&M rule is not necessary to prevent anticompetitive conduct because we have preserved the prohibition on joint ownership of transmission and switching facilities and also maintained various non-structural safeguards. These safeguards include the requirements to conduct all transactions at arm's length and to disclose the details of such transactions on the Internet, as well as obligation to make OI&M services available to unaffiliated rivals on a nondiscriminatory basis. These measures are sufficient to ensure that the BOCs "operate independently" from their long-distance affiliates, as the statute requires (until this requirement sunsets pursuant to section 272(f))

My only concern is the tension between this Order and the Commission's recent decision rejecting a request for forbearance from the OI&M rule.[1] Today, the Commission correctly concludes that the OI&M rule is not compelled by the language of section 272(b)(1); we are free to abandon it since other safeguards are sufficient to ensure that a BOC and its long-distance affiliate "operate independently." *See* Report and Order, ¶ 7 Four months ago, however, the Commission reached the opposite conclusion. The Commission held that section 10(d) precluded us from forbearing from the OI&M rule, on the theory that the rule was a "requirement" of section 271 and that section, in the Commission's view, has not yet been "fully implemented" (despite the fact that Verizon had already been granted section 271 authority in each of its states).[2] As my dissent pointed out, since the OI&M rule is not in fact a "requirement" of section 271, section

[1] *Petition of Verizon for Forbearance from the Prohibition of Sharing Operating, Installation, and Maintenance Functions Under Section 53 203(a)(2) of the Commission's Rules*, Memorandum Opinion and Order, 18 FCC Rcd 23525 (rel Nov 4, 2003) (*OI&M Forbearance Denial Order*)

[2] *OI&M Forbearance Denial Order*, 18 FCC Rcd at 23527, ¶ 8.

10(d) posed no bar to forbearance. While I am pleased that the Commission has now come around to recognize that the OI&M rule was but one choice among a range of permissible safeguards, I believe we should expressly overrule the earlier interpretation The damage has been effectively undone in this context (since the rule change obviates the need for forbearance), but the Commission's erroneous conclusion that it cannot forbear from *any* rule adopted pursuant to section 271 or 251(c) prior to "full implementation" of those sections — even where the rule is not compelled by the statutory text — could prevent us from taking appropriate deregulatory action in future proceedings

STATEMENT OF COMMISSIONER MICHAEL J. COPPS, CONCURRING

Re *Section 272(b)(1)'s "Operate Independently Requirement for Section 272 Affiliates (WC Docket No 03-228, CC Docket Nos 96-149, 98-141, 01-337)*

In Section 272, Congress required Bell companies to provide long distance services though a separate affiliate. Under the statute, the affiliate must maintain separate books, records and accounts; have separate officers, directors and employees; and must conduct all business with its parent on an arm's length basis, with transactions reduced to writing and available for public inspection. A separate affiliate may not obtain credit under conditions that permit creditors to have recourse to its parent. Bell companies are prohibited from discriminating between their own affiliate and other entities in the provision of services. This is a strikingly detailed list of obligations. Congress required every one of them in the Communications Act None are negotiable. All must be vigorously enforced.

Congress also required that the separate affiliate "operate independently" from its Bell company parent. As the Commission suggested as far back as 1996, this phrase is more ambiguous than its counterpart requirements in Section 272. As a result, the Commission came up with two rules to implement its meaning. The Commission eliminates one of these rules today—the requirement that affiliates provide separate operation, installation and maintenance functions. I support today's action because I do not believe that the statute compels this particular OI&M requirement.

I limit my support to concurring because I believe that with the removal of this kind of structural safeguard, it is the right time to consider a non-structural safeguard, namely, special access performance metrics. It was more than two years ago that the Commission introduced this idea with unanimous support. Special access services are critical to the business telecommunications economy. This proposal could be a tool to ensure quality and nondiscriminatory service Instead it is gathering dust on the regulatory shelf I hope the Commission will undertake a re-examination of its special access policy as the logical complement to the step we take here.

STATEMENT OF COMMISSIONER JONATHAN S. ADELSTEIN, CONCURRING

Re Section 272(b)(1)'s "Operate Independently" Requirement for Section 272 Affiliates, et al , Report and Order in WC Docket No 03-228, Memorandum Opinion and Order in CC Docket Nos 96-149, 98-141, 01-337

I concur in this Order on the belief that the complete prohibition against sharing of operating, installation, and maintenance (OI&M) services is not necessary based on this record, while retention of the joint ownership prohibition is.

Through section 272, Congress required a separate affiliate and imposed structural and transactional requirements between a Bell operating company (BOC) and its long distance affiliate, requiring such separation for a minimum of three years. Congress did not, however, explicitly specify how the affiliate was to "operate independently" from the BOC The Commission adopted the particular rules at issue here to give meaning to the "operate independently" statutory directive.

The lifting of structural protections is not a trivial matter. In this case, nevertheless, I am persuaded by this record that the complete prohibition on sharing of OI&M services is no longer necessary. A complete ban on such sharing is not statutorily mandated, and the record suggests that concerns against cost misallocation and discrimination in both price and performance can be addressed effectively in other ways.

Without question, the sharing of OI&M services between a BOC and its section 272 affiliate will result in measurable efficiencies. A complete OI&M restriction imposes costs and denies the economies of scale and scope inherent in the integration of some services. Allowing OI&M sharing will enable the BOCs to make better use of their dedicated and experienced workforces. On an integrated basis, the BOC local exchange companies' many office and field technicians could perform the same work more efficiently.

It is critical, however, that revising our rules to permit OI&M sharing not sacrifice the important goals of preventing improper cost allocation and discrimination, both in price and performance, by a BOC and its section 272 affiliate. I place heavy reliance on the BOCs' full compliance with the other statutory and regulatory safeguards, including the nondiscrimination provisions, the biennial audit and other public disclosure requirements, separate governance and arm's length dealings, and accounting protections. Full compliance with these other safeguards will go a long way toward protecting competitors and the public

I would have liked to have seen more analytical depth to this item, however. For example, we could have examined more specifically the services at issue to understand their operational impact or whether to draw any distinction between back office personnel

and systems, as the sharing of systems may cause greater concern We also have more direct experience with the section 272(d) audits and underlying performance data than what is reflected in the item I would have liked for that audit experience to have shed further light on the sufficiency of the other protections. In addition, I would have examined the relationship between special access performance measures and the issues implicated in this item. The Commission opened a proceeding on special access performance measurements more than two years ago, and I would have considered that in tandem with today's action

These concerns, however, do not lead me to disagree with the sharing of OI&M services and the benefit of better workforce utilization. Rather, I concur insofar as I would have examined in greater depth the services at issue and assured that any potential gaps in safeguards were fully addressed through protections such as special access performance measurements.